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NORTHERN ~~DIVISION~~

OFFICE OF REPORTS AND ESTIMATES

CENTRAL INTELLIGENCE AGENCY

WORKING PAPER

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Office of Reports and Estimates
Northern Division

BRITISH BRANCH

UNITED KINGDOM:

1. Organized labor's current position

The behavior of Britain's trade unions during the next few months is the key to the success of the devaluation move. That they will accept without any concessions the full impact of devaluation--the lowered real wages and standard of living--is doubtful. It was only with the greatest difficulty that the national labor leaders restrained demands for general wage increases before the devaluation. Even before 18 September, wage claims involving 4-5,000,000 workers were outstanding; these claims will be reinforced by the expected higher prices.

The Government is therefore expected to follow the policy of small raises for the lowest paid groups after drawn out negotiations. Such awards would raise industrial costs somewhat, reducing in some degree the trading benefits to Britain of devaluation; but they appear to be necessary for stability. At all events, labor unrest is expected to increase in the next few months, and the outcome depends largely on the leadership of both union and Labor Party leaders. These men must deflate the trade unions' expectations of continuous economic betterment irrespective of the condition of the national economy. This is a difficult task; its implications would naturally make most politicians hesitant, but especially Laborites, and it has so far not been attempted with the requisite vigor and inspiring leadership. Once undertaken, however, it may lead to a crisis within the labor movement.

2. Economic debate may foreshadow future developments

With the reconvening of Parliament on 27 September for a three-day debate on the economic situation there may be

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indications of what further measures the Labor Government will propose in order to derive the maximum benefit from devaluation. Since Labor Party leaders neglected to prepare public opinion, and particularly their own followers, for a decrease in the standard of living, the Government's incapacity (or incapacity) for positive leadership and lucid clarification of the situation will be of the utmost importance.

Although public and trade union reaction to devaluation as yet does not warrant the expectation of a political crisis, developments--such as shifts in the cabinet or a split within the labor movement--which did not previously deserve serious attention, can not be ruled out. The likelihood of a serious political shakeup is slight, but it deserves mention largely because it has for so long been assumed to be a virtual impossibility.

3. Devaluation damages cross-channel relations

The implications of devaluation for Britain's relations with the western European countries are not yet clear. The move is not helpful to those relations, however, and anti-British feeling is widespread. Though the UK Government is now preoccupied with its new domestic problems, officials are showing some belated concern over reactions from the continent, and they can be expected to take steps necessary to heal any serious breaches that may appear.

Though the immediate reaction of France, particularly, is one of resentment--not at the fact but at the extent of the exchange adjustment--the French leaders can hardly have expected the UK to base its action on what would have been best for the French economy. Charges that Britain has launched "economic warfare" seem therefore to be exaggerated, and the more emotional criticism of French and Belgian officials may have been made for domestic consumption.

Much French and Belgian official resentment stems from not being consulted. The British procedure in devaluating will not help the UK to refute charges that its economic cooperation amounts largely to lip-service; though the British failure to discuss their intentions with their western European trading

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partners has precedent, the opposite procedure would have better served the avowed cause of economic cooperation (for whatever that is worth). In this connection it is noteworthy that the British Commonwealth countries and Ireland seem to have been consulted in advance, or at least informed. This indicates once more the predominance in UK thinking of Commonwealth over European relations.

4. Britain's Middle East position essentially unaffected by devaluation

Devaluation of the British pound will, according to preliminary estimates, have little effect on the British economic position in the Middle East. Those countries having closest economic ties with Britain -- Iraq, Egypt, and Jordan -- have devaluated also, and the internal economic consequences are not expected to raise serious threats to their political stability. Britain will obtain some limited economic advantages from the fact that British firms will now be in an improved competitive position vis-a-vis US firms which have been attempting to establish themselves in Middle Eastern markets.

It is estimated that there will be an increase in the amount of sterling which Britain will have to pay out in oil royalties because rates established while Britain was on the gold standard are in some cases based on a fixed number of gold shillings per ton of oil. In the case of Iran, which has not devaluated its currency, the annual payments of the Anglo-Iranian Oil Company will be increased by about £10,000,000.

5. UK modifying China trade policy

A compromise in the UK's China trade policy seems to be in the making, whereby the UK will agree to join the US in banning the export to Communist China of certain strategic materials including high grade oils, heavy trucks, aircraft parts, signal equipment and machine tools. The US requested in July* that Britain apply to Communist China the regular L-A and L-B lists used to restrict exports to Soviet-dominated areas in Europe, but the British, who have consistently been reluctant to impose any stiff restrictions on their rich China

*(See NB Weekly, No. 76, 8 August)

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trade(though never wishing to sell military equipment proper), agreed to an embargo on the I-A list and made even that conditional upon similar action being taken by the other Western nations trading in China. The embargo which is now unofficially reported to be impending would not be conditional on parallel embargoes by the UK's European trade competitors. The UK will, however, strenuously attempt to keep these restrictive practices to a minimum because of its present trade plight, the magnitude of British investment in China, the necessity of curtailing regulations governing the flow of trade through Hong Kong in order to maintain that port's status as one of the great entrepot centers in the Far East, and the hope that by these means the Communist regime can be convinced trading with Britain is more in its interest than expropriating British investments. The willingness thus to modify its China policy is primarily to be attributed to a desire to maintain a united front with the US in China, though the continued Communist advance is probably a factor also.

COMMONWEALTH AND EMPIRE

6. Most of Commonwealth cautiously "goes along" on sterling devaluation

With certain exceptions, currency devaluation equivalent to the UK's seems to have come almost automatically in the Dominions and to have been received so far with the cautiously expressed conviction that their main economic positions will not be greatly affected, though the increased pressure on already scarce dollar allocations is of course recognized. Apart from Canada,* the exceptions are on the Indian sub-continent, where great bitterness and confusion have been introduced into the economic life of India by Pakistan's unexpected refusal to devalue. The most serious aspects of this situation naturally concern Indian-Pakistani relations and only indirectly the UK, but the UK is immediately faced with higher prices for Pakistani raw materials and, in India, with the charge of the Government's critics that it was Indian subservience to British economic influence which has let Pakistan gain this advantage.

The close economic relations of Ceylon, Australia, New Zealand, and South Africa with the UK have evidently prevented

*See article page 5

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any serious controversy in these countries as to the wisdom of their maintaining their old relationship with the pound sterling. Australia and New Zealand have dollar deficits which will probably be harder to meet with the pound depreciated; Australian Prime Minister Chifley has attempted to calm apprehensions on this subject by emphasizing publicly that dollar goods represent only a small part of the country's total imports, while the New Zealand Government has so far taken the different course of continuing, as before, to talk of seeking an American loan. In South Africa devaluation was greeted by a boom in gold shares since the country's not inconsiderable gold sales to the UK will now net some 30 per cent more pounds than before. The Union's already bad dollar position is made neither better nor greatly worse, since nearly all of its exports to the US consist of gold still pegged at \$35 per ounce.

Canada

7. Canada's foreign trade future brighter

Devaluation of the Canadian dollar and the decision taken just previously at the Washington Conference to liberalize ECA wheat-purchasing arrangements are expected to counteract greatly the deterioration in Canada's foreign trade position which occurred in the first six months of 1949. Prior to the conference the gradual decrease in Canadian exports to the US, coupled with the decline in ECA's Canadian purchasing, had led to plans for renewed restrictions on the import of US goods in order to conserve dwindling Canadian reserves of gold and US dollars.

The main purpose of the 10% devaluation of the Canadian dollar is to protect these reserves by decreasing Canadian imports from the US and increasing Canadian exports to the US. Canadian imports from the UK should be stimulated with their new price advantage, particularly in such lines as textiles. The volume of UK purchases of Canadian products should, in comparison, be less affected by the change in price because of Britain's fixed requirements for commodities like wheat; where price is an important factor, Canadian sales in the UK may suffer but not so much as if Canada had not devalued at all.

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Since pre-devaluation British prices were much higher than Canadian prices on most commodities, the 10% devaluation was considered sufficient to meet competition in most instances. US and UK trade together accounts for some 75% of Canada's total foreign trade; elsewhere, two possible effects of Canadian devaluation are that it may cause other sterling countries to switch dollar purchases from the US to Canada wherever able, and that OEEC countries will probably make greater efforts to increase the latitude on their use of ECA dollars to make a similar switch. Devaluation will have its adverse effects also. Largely as a result of more expensive imports from the US, Canada's cost of living will probably rise somewhat. Furthermore, the long-term trade problem still exists so long as sterling is not freely convertible, with Canada facing increased competition in foreign markets as a result of the greater devaluation of other currencies.

The Washington Conference gave Canada some immediate aid by permitting the UK to purchase \$175 million of wheat in Canada with ECA funds, and it is possible that similar ECA allowances on certain other items may follow. Largely as a result of this, it is expected that UK and sterling area cuts in purchases in Canada in the next nine months will be closer to 10 or 15 per cent rather than the expected 25 per cent.

IRELAND

8. Devaluation's effect probably not great

For Ireland, devaluation seems likely to mean some decrease in its dollar deficit and some increase in the cost of living. Except in certain essential items such as wheat, imports of dollar goods, nearly all of which are currently covered by ECA loans, are likely to decline in volume because of their higher price in terms of pounds. Dollar tourism should be stimulated; but there is no likelihood of appreciable expansion of Ireland's visible dollar exports. Although the price level in the UK always has some effect on the Irish price level, Ireland's greater self-sufficiency in food production will probably prevent devaluation's adverse effect on the cost of living from being as great as in the UK. Increased prices on some items are, however, inevitable. Devaluation is not

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likely to raise crucial political issues dangerous to the stability of the Government, although it will probably stimulate renewed discussion of the long-term advisability of keeping the Irish pound linked at par with the pound sterling.

9. Ireland may withdraw its UN application

The third Russian veto of Ireland's application for admission to the UN will probably prompt reconsideration of whether it should be withdrawn. The Irish would undoubtedly like to be in the UN- to discuss partition and other "vital" international issues. But there is some feeling that it would be degrading to keep their application pending indefinitely, even though they take pride in the Russian attitude toward it. Other considerations are the strain membership would impose on the budget and small staff of the Department of External Affairs, and a profession of little faith in the effectiveness of the UN anyhow. In 1948, the Government was seriously considering withdrawing its application but was dissuaded, at least in part, by US representations. In June 1949, the Minister for External Affairs brushed aside a suggestion that the application be withdrawn. The third veto is likely to bring the matter up again.

SCANDINAVIAN BRANCH

NORWAY

1. Effects of devaluation

Although the impact of currency devaluation on Norway is still problematical it appears certain that the Government with foreign exchange control and the licensing of exports and imports can handle any economic disruption which might ensue. Labor will demand continued price controls, even additional subsidies if necessary. With wage rates tied to the cost of living index the government will attempt to keep the price level below the point at which increased wages may be demanded.

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Since many merchant vessels, particularly tankers, operate on long-term dollar contracts, Norway's merchant marine, a primary source of dollars, may benefit from devaluation. The pulp and paper industry has been operating below capacity because of inability to dispose of its products in competitive markets. Lower prices in terms of dollars may result in greater sales in dollar areas.

The outcome of the national election, scheduled for 10 October, should not be materially affected by devaluation which has not been an issue during the campaign.

SWEDEN

2. Benefits expected from devaluation

Unless there is an inflationary spiral, which is not expected, Sweden with a dollar deficit in foreign exchange will benefit from currency devaluation. An impetus to increase exports to the US will be provided. Sweden has the necessary production facilities and, assuming sufficient US demand for Swedish goods, ultimately will increase its dollar earnings.

The principal exports to the US fall into two categories, forest products and iron ore. Even with reduced pulp prices sales to the US had dropped drastically prior to devaluation. Now, however, with the krona revalued vis-a-vis the dollar pulp again should be in a competitive position, although the full amount of the 30 percent devaluation will not be passed on immediately as is indicated by Swedish pulp cartel action advising unchanged dollar quotations. In the postwar period the US has been importing between 1.5 to 2 million tons of high grade Swedish iron ore annually, and demand should increase with any cut in dollar prices.

Since the success of the economic program depends on domestic price and income stabilization, the effect of devaluation on the cost of imports causes considerable concern. Fuel and raw materials constitute nearly 40 percent of imports, but the bulk originates in non-dollar areas. Unless there

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are sharp price increases in Britain and other devaluating countries, which would have a sudden inflationary effect on the Swedish economy, no increase in the price of imports from those areas is expected. However, there will be an immediate increase in the cost of raw materials and capital goods imported from the US. This may eventually be reflected in the Swedish price structure. Sweden is approximately 90 percent self-sufficient in food production with only minor imports from dollar areas.

Holding the wage line represents an important problem arising from devaluation, but the government has received the support of the Swedish Confederation of Trade Unions in return for the promise to hold down living costs by reducing consumption taxes and import duties and perhaps raising subsidies. (Prior to devaluation farmers agreed not to request higher prices for agricultural products and were granted a small subsidy on milk.) The Central Council of the Confederation of Trade Unions advised its 45 affiliated trade unions to extend present wage agreements for the year 1950, and it is likely they will accept the Central Council's recommendation, despite devaluation. Therefore, in spite of an increase in the cost of some imports, the cost of living is not expected to rise appreciably.

ICELAND

3. Devaluation eases political situation

Devaluation of the krona, forced by Britain's devaluating the pound sterling, may be a mixed blessing for Iceland's economy, but it has removed a thorny political issue from the current election campaign. Economists studying Iceland's economic problems and some Government leaders have for a time considered unilateral devaluation essential to put exports -- primarily fish products -- on a competitive basis in European markets. But the parties of the weak coalition Government were unable to agree on the political desirability of devaluation, and the Social Democratic Party was outspokenly opposed to it. Since devaluation is no longer a political issue the Social Democrats can cooperate with the non-Communist

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parties in the formation of a government after the elections.

Had devaluation of the krona come as an independent action, Iceland's competitive position in the European markets would have benefitted. Government subsidies which have been necessitated by high production costs in order to maintain export prices at competitive levels could have been reduced or eliminated. However, since those countries with which Iceland trades have also devaluated their currencies the trading pattern will not be materially affected.

In order to benefit from devaluation production costs must be kept down, i.e., no wage increases. Since it is doubtful that a government strong enough to impose or maintain effective economic controls will emerge from the elections, the outlook for checks on wages is not promising. The Federation of Labor is already preparing to terminate current labor agreements with their wage ceilings. Dagsbrun, the largest and most important union in Iceland, may strike unless the impact of devaluation on the working classes is substantially softened by wage increases, subsidies, or other measures. Such a strike, if prolonged, would completely cripple Iceland's economic activities.

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